FILE COPY

No. 76

Office - Supreme Court, U. S.
FILED
OCT 18 1941
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

THE FEDERAL LAND BANK OF SAINT PAUL,
Petitioner,

v.

BISMARCK LUMBER COMPANY, AND JOHN GRAY, AS TAX COMMISSIONER OF THE STATE OF NORTH DAKOTA, *Respondents.*

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF NORTH DAKOTA

BRIEF FOR THE RESPONDENTS

ALVIN C. STRUTZ,
Attorney General,
P. O. SATHRE,
Assistant Attorney General,
Attorneys for Respondents,
Bismarck, North Dakota.

Hayward Printing Co., 512 Fourth Ave., So., Minneapolis

INDEX.

	Page
Jurisdiction	1
Statement	1
Points Conceded	4
Issues	4
Argument	5
Activities of petitioner in purchasing lumber and other materials to be used in repairing buildings on its farms are not governmental functions	12

CASES CITED.

Bank of United States vs. Planters' Bank of Georgia, 9 Wheat. 904, 6 L. Ed. 244 18
Clallam County vs. United States, 263 U. S. 341 ..... 6, 8
Federal Land Bank vs. Priddy, 295 U. S. 229 ..... 9, 10, 13
First National Bank vs. Commonwealth of Kentucky, 9 Wall. 353, 19 L. Ed. 701 17
First National Bank vs. Fellows, 244 U. S. 146, 61 L. Ed. 1233 16
Graves vs. New York, 306 U. S. 465, 83 L. Ed. 927 19
Indian Motorcycle Co. vs. United States, 283 U. S. 575 14
M'Culloch vs. Maryland, 4 Wheat. 316 ..... 6, 7, 14
New Brunswick vs. United States, 276 U. S. 547 ..... 6, 8
Osborn, et al., vs. The Bank of United States, 9 Wheat. 738 ..... 6, 7
Pittman vs. Home Owners' Loan Corporation, 308 U. S. 321 11
Smith vs. Kansas City Title and Trust, 255 U. S. 180, 41 S. Ct. 243, 65 L. Ed. 577 9
State of North Dakota vs. Olson, 33 Federal (2d) 848 20
United States vs. Railroad Company, 17 Wall. 322 6
Van Brocklin vs. State of Tennessee, 117 U. S. 151 ..... 6, 8

STATUTES CITED.

Section 26, Federal Farm Loan Act of July 17, 1916 (39 Stat. 360, 12 U. S. C., Section 931) 6, 16
Section 701, 12 U. S. C. A. 11
Section 4 (c), Home Owners' Loan Act 11, 12
48 Stat. at L. 131, Chap. 64, 12 U. S. C. A., Sec. 1463 (e), (f) 11
48 Stat. at L. 262, Ch. 6, Compiled Statutes 1916, Section 9794 16

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

THE FEDERAL LAND BANK OF SAINT PAUL,
Petitioner,

vs.

BISMARCK LUMBER COMPANY, AND JOHN GRAY, AS TAX COMMISSIONER OF THE STATE OF NORTH DAKOTA, *Respondents.*

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF NORTH DAKOTA.

BRIEF FOR THE RESPONDENTS

JURISDICTION

The jurisdiction is conceded and rests on Section 237 (b) of the Judicial Code as amended by the Act of February 13, 1925.

STATEMENT

This is an action brought by the plaintiff, the *Federal Land Bank of Saint Paul, petitioner, vs. Bismarck Lumber Company, and John Gray, as Tax Commissioner of the State of North Dakota*, and is based upon the following facts:

The State Sales Tax Act of the State of North Dakota (Chapter 249, Laws of 1937) in force during the time involved in this controversy provided:

> "Sec. 2. There is hereby imposed * * * a tax of two percent (2%) upon the gross receipts from all sales

of tangible personal property, consisting of goods, wares, or merchandise, except as otherwise provided in this Act, sold at retail in the State of North Dakota to consumers or users * * *."

"Sec. 3. There are hereby specifically exempted from the provisions of this Act and from computation of the amount of tax imposed by it, the following: (a) The gross receipts from sales of tangible personal property which this State is prohibited from taxing under the Constitution or laws of the United States or under the Constitution of this State * * *."

"Sec. 4. Taxes paid on gross receipts represented by accounts found to be worthless and actually charged off, for income tax purposes may be credited upon subsequent payment of the tax herein provided; provided, that if such accounts are thereafter collected by the retailer, a tax shall be paid upon the amount so collected * * *."

* * * * * * * * * *

"Sec. 6. Retailers shall add the tax imposed under this Act, or the average equivalent thereof, to the sales price or charge and when added such taxes shall constitute a part of such price or charge, shall be a debt from consumer or user to retailer until paid, and shall be recoverable at law in the same manner as other debts * * *."

"Sec. 7. It shall be unlawful for any retailer to advertise or hold out or state to the public or to any consumer, directly or indirectly, that the tax or any part thereof imposed by this Act will be assumed or absorbed by the retailer or that it will not be considered as an element in the price to the consumer, or if added, that it or any part thereof will be refunded."

The defendant, Bismarck Lumber Company, is engaged in the business of selling lumber and other building materials as a retailer in the city of Bismarck, North Dakota. The plaintiff, Federal Land Bank of Saint Paul, had acquired certain real property in the State through mortgage foreclosure proceedings. The plaintiff purchased from the defendant Lumber Company certain lumber and other building

material to be used in repairing, improving and maintaining the buildings on the farm lands which it had acquired and owned.

The price of the materials thus purchased was $401.00. To this sum the defendant added $8.02, the amount of the two per cent (2%) sales tax. The plaintiff paid the sales price of $401.00, but refused to pay the sales tax of $8.02, basing its refusal on the claim that under the provisions of Section 26 of the Federal Farm Loan Act and the Constitution of the United States it was exempted from payment of the North Dakota sales tax.

The defendant, Lumber Company, however, contended that the building material so sold by it to the plaintiff was subject to the sales tax, and that, therefore, it was the legal duty of the defendant to add the amount of the sales tax to the purchase price.

The plaintiff, Federal Land Bank, brought action in the District Court of Burleigh County against the Lumber Company and the Tax Commissioner of the State for the purpose of procuring a determination of the issues thus raised, and "for a declaratory judgment adjudicating and determining the rights, liabilities, status and legal relations of the parties, and for a determination whether the sales in question were subject to the sales tax, and whether the Lumber Company might legally add the amount of the sales tax to the sales price and whether the plaintiff, Land Bank, was under obligation to pay the same."

The District Court found for the defendant, and held that the sales by the Lumber Company to the plaintiff were subject to the state sales tax; that the Lumber Company was required to collect and pay over to the State the sales tax on such sales, and therefore, add the amount thereof to the sales price.

Judgment was accordingly entered by the District Court.

On appeal to the State Supreme Court, the judgment of the District Court was affirmed, and the matter is now before this Court on a Writ of Certiorari to the Supreme Court of the State of North Dakota.

POINTS CONCEDED

1. That the Act of Congress creating the Federal Land Bank is valid and that the other Land Banks are instrumentalities of the government, so far as they are engaged in discharging governmental functions.

2. That under the provisions of Chapter 249 of the Session Laws of North Dakota for 1937, and amendments thereto, known as the Sales Tax Act, the tax is imposed upon the buyer and not upon the seller; the seller acting simply as a collecting agent for the State.

Jewel Tea Company vs. State Tax Commission, 70 N. D. 229, 293 N. W. 386.

ISSUES

The issues before this Court are:

Whether in the transaction of purchasing lumber and other building materials from the defendant, Bismarck Lumber Company, within the State of North Dakota, the plaintiff, the Federal Land Bank, is exercising a necessary governmental function, and whether the imposition of the North Dakota sales tax upon such transactions is prohibited by Section 26 of the Federal Farm Loan Act.

12 U. S. C. A., par. 931.

Section 26 of the Federal Farm Loan Act of July 17, 1916 (39 Stat. 360, 12 U. S. C., Sec. 931).

"Sec. 26. That every Federal land bank and every national farm loan association, including the capital

and reserve or surplus therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State and municipal and local taxation.

Nothing herein shall prevent the shares in any joint stock land bank from being included in the valuation of the personal property of the owner or holder of such shares, in assessing taxes imposed by authority of the State within which the bank is located; but such assessment and taxation shall be in manner and subject to the conditions and limitations contained in section fifty-two hundred and nineteen of the Revised Statutes with reference to the shares of national banking associations.

Nothing herein shall be construed to exempt the real property of Federal and joint stock land banks and national farm loan associations from either State, county, or municipal taxes to the same extent, according to its value, as other real property is taxed."

ARGUMENT

It is the contention of the defendants that the purchase of building materials to be used in repairing buildings on its farms is not a necessary governmental function, nor incidental thereto.

The plaintiff, Federal Land Bank, acquired its lands through foreclosure of mortgages executed by the owners of the land. The foreclosure proceedings were had and title perfected in the plaintiff under the provisions of the laws of the State of North Dakota. The plaintiff acquired its title in the same manner as scores of other property owners in the State, and enjoys the same protection of its property

and property rights as other corporations and private citizens.

The building materials purchased by the plaintiff were used in repairing, preserving and maintaining the buildings upon the lands it had acquired and from the nature of the case, such buildings are fixtures and part of the realty. The plaintiff claims exemption from the sales tax of the State of North Dakota under the provisions of Section 26 of the Federal Farm Loan Act of July 17, 1916 (39 Stat. 360, 12 U. S. C., Section 931).

In their brief counsel for plaintiff wholly ignore the proposition as to whether the purchase of building materials by the plaintiff is an exercise of a necessary governmental function. In other words, they assume that it is, and then dismiss it without further argument or citation of authority.

Counsel for plaintiff, however, cite numerous cases in support of the general proposition that every Federal Land Bank is exempt from State taxation, except taxes upon real estate held by said banks. Among the cases cited are the following:

M'Culloch vs. Maryland, 4 Wheat. 316.

Osborn, et al., vs. The Bank of United States, 9 Wheat. 738.

United States vs. Railroad Company, 17 Wall. 322.

Van Brocklin vs. State of Tennessee, 117 U. S. 151.

Clallam County vs. United States, 263 U. S. 341.

New Brunswick vs. United States, 276 U. S. 547.

We shall attempt briefly to analyze these cases in order to ascertain their application to the issues in the instant case.

In the case of *M'Culloch vs. Maryland, supra*, it was held that Congress had the constitutional power to incorporate a bank and further "the power of establishing a corporation

is not a distinct sovereign power of any government, but only a means of carrying into effect *other powers which are sovereign*. Whenever it becomes an appropriate need of exercising any other powers given by the Constitution to the government of the Union, it may be exercised by that government."

Further, with reference to the principles laid down, the Court said:

> "That these states have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government."

The opinion of the Court continues:

> "This opinion does not deprive the states of any resources which they originally possessed. It does not extend to a tax paid by the real property of the bank, in common with the other real property within the state, nor to a tax imposed on the interest which the citizens of Maryland may hold in this institution, in common with other property of the same description throughout the state. But this is a tax on the operations of the bank, and is, consequently, a tax on the operation of an instrument employed by the government of the Union to carry its powers into execution. Such a tax must be unconstitutional."

In the case of *Osborn vs. United States*, 9 Wheat. 738, the doctrine laid down in *M'Culloch vs. Maryland* was re-examined. The Court said:

> "We do not maintain that the corporate character of the bank exempts its operations from the action of state authority. If an individual were to be endowed with the same faculties, for the same purposes, he would be equally protected in the exercise of those faculties. The operations of the bank are believed not only to yield the compensation for its services to the government, but to be essential to the performance of those services. Those

operations give its value to the currency in which all the transactions of the government are conducted. They are, therefore, inseparably connected with those transactions. They enable the bank to render those services to the nation for which it was created, and are, therefore, of the very essence of its character, as national instruments. The business of the bank constitutes its capacity to perform its functions, as a machine for the money transactions of the government. Its corporate character is merely an incident, which enables it to transact that business more beneficially."

In the case of *Van Brocklin vs. Tennessee*, *supra*, the substance of the decision is to the effect that land situated in the State which is acquired by the United States through sale or through taxes levied pursuant to the sale are not subject to State taxation while still owned by the United States.

In the case of *Clallam County vs. United States*, it was held that a State cannot tax the property of a corporation organized by the federal government to produce material for war purposes, the property of which is conveyed to the government, or bought with money of the United States and used solely for the purpose of its creation. The function exercised by that corporation was exercised for purely governmental purposes, and in fact, could be exercised only by the federal government itself, or by the governmental agency created by the government for that purpose. It seems clear that only by far-fetched and extreme logic could it be held that purchase by the Federal Land Bank of building material to be used on taxable farms, is a governmental function.

In the case of *New Brunswick vs. United States*, it was held that upon sale by a corporation belonging to the federal government under an Act of Congress of property acquired by it for governmental purposes, which could not be sold without reserving a first lien for unpaid purchase

money, when sufficient payments are made to entitle the purchaser to a deed, local taxes may be assessed against the entire property and make the lien enforceable against the interest of the purchaser, but not against that of the government.

In the case of *Smith vs. Kansas City Title and Trust*, 255 U. S. 180, 41 S. Ct. 243, 65 L. Ed. 577, it was held that Federal Land Banks and joint stock land banks having been created by Congress in the exercise of its legitimate authority by the Federal Farm Loan Act of July 17, 1916, as amended by the Act of January 18, 1918, the power to make farm loan bonds issued by them upon securities of farm mortgages and notes exempt as to principal and interest from federal, state, municipal and local taxes necessarily follows. We find no language in *Smith vs. Kansas City, supra*, which by implication or otherwise has any application to the issues in the case at bar. We respectfully submit that a transaction such as the purchase by the plaintiff of building materials for its farm buildings, is not analogous to the issuing of farm loan bonds secured by farm mortgages and notes, since such bonds are specifically exempted from taxation by the State. The remoteness of the relationship would prohibit the extension of tax exemption to such transactions unless specifically granted by Congress.

While Federal Land Banks are federal instrumentalities and as such exercise governmental functions, they are also authorized to and do engage in private business in competition with private citizens and corporations.

In the case of *Federal Land Bank vs. Priddy*, 295 U. S. 229, this Court, speaking through Mr. Justice Stone, now Chief Justice, said:

> "In interpreting Section 4, it is to be borne in mind that federal land banks, although concededly federal instrumentalities, possess also some of the characteristics of private business corporations. See *Federal Land*

Bank vs. Gaines, supra (290 U. S. 254, 78 L. ed. 301, 54 S. Ct. 168). The statute does not contemplate that their stock is to be wholly, or even chiefly, government owned. Its acquisition by private investors is permitted §5, and its subscription by the borrowing national farm loan association is compulsory. §5. The operations of the federal land banks are, in part at least, for profit. §5. In the conduct of their business they may enter into contracts, §4, borrow money, receive interest and fees, §13, pay the expenses and commissions of agents, §15, and pay dividends on their stock, §5. While they are required to deposit in trust farm mortgages as security for farm loan bonds, §13, they may acquire and dispose of property, in their own right, including land, §13. They thus have many of the characteristics of private business corporations, distinguishing them from the government itself and its municipal subdivisions, and from corporations wholly government owned, and created to effect an exclusively governmental purpose. This is a circumstance which gives some support to the inference that the intended scope of the liability to suit includes judicial process incident to suit. See *District of Columbia vs. Woodbury*, 136 U. S. 450, 455, 34 L. ed. 472, 474, 10 S. Ct. 990; *Clallam County vs. United States*, 263 U. S. 341, 345, 68 L. ed. 328, 331, 44 S. Ct. 121."

In the syllabus of the same case, *Federal Land Bank vs. Priddy, supra*, we find the following statement:

> "Federal land banks, though Federal instrumentalities, possess some of the characteristics of private business corporations, in that the acquisition of their stock by private investors is permitted, their operations are, in part at least, for profit, and that they may acquire and dispose of property, including land, in their own right."

The Federal Farm Loan Act provides that the banks created pursuant to its provisions, may be designated:

> "depository of the public money * * * and they may also be employed as financial agents of the Government;"

and they shall perform all said reasonable duties as depositories for public money as financial agents of the Government as may be required of them."

Section 701, 12 U. S. C. A.

In the case of *Pittman vs. Home Owners' Loan Corporation*, 308 U. S. 321, the question for decision was whether a mortgage executed by the Home Owners' Loan Corporation was subject to a tax imposed by a statute of the State of Maryland. Said statute imposed a tax "upon every instrument in writing recorded or offered for record with the Clerks of the Circuit Court of the respective counties or the Clerk of the Superior Court of Baltimore City on or after June 1st, 1937, to and including September 30th, 1939, * * * including mechanics' liens, deeds, mortgages * * *."

The tax imposed was at the rate of ten cents for each $100.00 or fractional part thereof. In addition to the tax thus imposed, the clerks were required to collect a charge of fifty cents for each instrument recorded or offered for record.

Section 4 (c) of the Home Owners' Loan Act provides that "the bonds issued by the corporation shall be exempt both as to principal and interest from all taxation, except surtaxes, estate, inheritance and gift taxes, now or hereafter imposed by the United States * * * or by any State, county, municipality or local taxing authority."

Said Act provided further:

"The Corporation, including its franchise, its capital, reserves and surplus and its loans and income, shall likewise be exempt from such taxation; except that any real property of the Corporation shall be subject to taxation to the same extent, according to its value, as other real property is taxed."

48 Stat. at L. 131, Chap. 64, 12 U. S. C. A., Sec. 1463 (c), (f).

One of the questions involved was as to the meaning of the

term, "loans." In discussing this question, Chief Justice Hughes said:

> "The critical term in the present relation is 'loans.' We think that this term, in order to carry out the manifest purpose of the broad exemption, should be construed as covering the entire process of lending, the debts which result therefrom, and the mortgages given to the Corporation as security. The Home Owners' Loan Act required that the loans made by the Corporation shall be secured by a duly recorded home mortgage."

The inference to be drawn from the foregoing statement of Chief Justice Hughes would imply that the term, "loans," includes mortgages, and under the specific provisions of Section 4, *supra*, of the Home Owners' Loan Act, mortgages would be exempt from taxation.

The tax sought to be imposed under the Maryland statute, *supra*, was in fact, a direct tax upon the mortgage taken by the Home Owners' Loan Corporation and the imposition of such tax would be in violation of said Section 4 of the Home Owners' Loan Act, which provides:

> "First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation."

Activities of Petitioner in Purchasing Lumber and Other Materials to Be Used in Repairing Buildings on Its Farms Are Not Governmental Functions.

We submit that the activities of the plaintiff, Federal Land Bank, in purchasing material to be used in repairing buildings upon its property is engaged in an activity which is not a governmental function and which distinguishes it

from the government itself, and from corporations wholly government owned and created to effect an exclusively governmental purpose.

Governmental functions must be distinguished from those which are private in their nature. We contend that when Congress enacted the Federal Farm Loan Act it was not contemplated, nor was it intended that the immunity from taxation provided therein should apply or extend to transactions such as the one in controversy in the case at bar.

This theory is supported by the decision in the case of *Federal Land Bank vs. Priddy*, 295 U. S. 229, 70 L. Ed. 408. It was therein held that federal land banks are subject to attachment and execution, at least where there will be no direct interference with any function performed by them as federal instrumentalities, in view of the provisions of the Federal Farm Loan Act permitting them to be sued "as fully as natural persons."

It was further held that the Federal Land Banks possess some of the characteristics of a private business corporation; that the remedies afforded by the Federal Farm Loan Act to their creditors are identical with those given to creditors of joint stock land banks; that Federal Land Banks pay dividends on their stock; that while they are required to deposit in trust farm loans as security for farm loan bonds, they may acquire and dispose of property in their own right, including land; that they have many of the characteristics of private business corporations, distinguishing them from the government itself and from corporations wholly government owned and created to effect an exclusively governmental purpose.

Under the principles laid down in the cases cited, the test is whether the taxes are laid on transactions involving an exertion of governmental functions and their bearing on governmental operations, and whether such taxes would have

the effect to "retard, impede, burden or in any manner control the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government."

M'Culloch vs. Maryland, 4 Wheat. 316.

Indian Motorcycle Co. vs. United States, 283 U. S. 575.

As was said by the Supreme Court of the State of North Dakota in the case from which this appeal is taken:

> "The Appellant, Federal Land Bank, is engaged in the business of loaning money to farm owners. It secured these loans by mortgages upon farms. Certain of its mortgagors defaulted. Appellant foreclosed and acquired title to the security. The land thus acquired had buildings on them. The buildings were in disrepair. Lumber was required to repair them in order to conserve the buildings and make them habitable for tenants. Appellant bought lumber to make these repairs. The State seeks to impose the sales tax here challenged—a tax which all other purchasers of lumber must pay. The appellant claims immunity from the tax on the ground that it is a federal instrumentality. If we read the case of *M'Culloch vs. Maryland, supra*, aright, that claim must be predicated on the theory that to exact the tax would constitute an interference with the operations of the federal government. There can be no ground for such a contention here. It is true that the tenuous device resorted to by Congress to clothe the federal land banks in the garb of governmental instrumentalities and thus render their bonds tax exempt was held sufficient. *Smith vs. Kansas City Title & Trust Company, supra*. And in *Federal Land Bank vs. Crosland*, 261 U. S. 374, 43 S. Ct. 385, 67 L. ed. 703, 29 A. L. R. 1, the exemption from taxation of the real estate mortgages taken by the banks was sustained. But it is one thing to hold the bonds of the land banks and the securities on which they are based tax exempt, and quite another to say that this tax exemption can be projected to so remote a business transaction as the purchase of lumber to repair buildings on lands acquired by the banks in an enterprise additional to rather than inci-

dental or related to the ostensible governmental purposes for which they were created. Certainly the imposition of the tax on the transaction here in question could not hinder or embarrass the performance of the governmental functions—acting as a depositary and financial agent and buying government securities the appellant was created to perform. Shadow ought not to be confused with substance. 'The rule that governmental instrumentalities are immune from taxation will not be mechanically applied regardless of the consequence to the operations of government.' *Educational Films Corporation of America vs. Ward, supra.* And we cannot believe that the mere designation of an individual or corporation as a governmental agent confers on Congress the power to absolve every transaction in which that agent may engage or the property used or acquired in those transactions from liability to taxation in the state taxing district wherein the transactions are performed or the property held."

We cannot state more clearly the fundamental proposition involved here, than it is stated in the foregoing quotation. The petitioner is engaged in the business of a competitive character. The petitioner competes with private corporations and private citizens engaged in similar business and who are subject to and must pay the sales tax from which petitioner claims that its transactions are immune. Such immunity can be successfully claimed only upon the theory that the transaction involved is an exercise of a governmental function, by the federal government, and that a tax imposed thereon would impede, obstruct and retard the government in the execution of its governmental powers. It should be noted that the transaction involved here is not a governmental function, nor can the tax sought to be imposed thereon impede, obstruct or retard the government in the discharge of its sovereign function.

That taxes will be paid out of funds owned and controlled by the petitioner is not sufficient to sustain the claim that

they are paid out of government funds. If paid, they certainly will not be paid out of federal money placed in the Federal Land Bank as a government depositary.

Clearly the business of loaning money to farmers and taking mortgages upon the farms to secure payment of such loans is not essential to enable the bank to perform functions that are governmental in their character. The immunity provided by Section 26 of the Federal Farm Loan Act which provides "that every Federal Loan Bank and every National Farm Loan Association, including the capital and reserve or surplus therein and income derived therefrom shall be exempt from Federal, State, municipal and local taxation, except taxes upon real estate * * *."

We submit it was intended to include funds and activities which were held to be instrumentalities of the government of the United States which were essential and incidental to the exercise of governmental functions. In the case of *First National Bank vs. Fellows*, 244 U. S. 146, 61 L. Ed. 1233, it was held that Congress did not exceed its powers under the United States Constitution, Article I, Section 8, Class 18, giving it power to make "all laws which shall be necessary and proper for carrying into execution" the powers expressly given by the Constitution when giving authority to the Federal Reserve Board by the Act of December 23, 1912 (38 Stat. at L. 262, Ch. 6, Compiled Statutes 1916, Section 9794 (Section 11k), to grant a special permit to national banks applying therefor when not in contravention of state or local laws, the right to act as trustees, executors, administrators or registrars of stocks and bonds under such rules and regulations as the Board may prescribe.

It appears, therefore, that the rights thus given to the national banks to act as trustees, executors, administrators, etc., were sustained on the theory that it was necessary to enable such banks to operate on an equal footing with pri-

vate corporations authorized by local laws to engage in such business.

On the question as to whether a tax imposed by a state government upon another state government or upon the federal government, the test is whether such tax obstructs the governmental operations of government upon which it is imposed. If it does, it is invalid; if it does not, it is valid.

In the case of *First National Bank vs. Commonwealth of Kentucky*, 9 Wall. 353, 19 L. Ed. 701, the Court, in discussing the proposition as to whether a tax by one government upon the activities of another, would in any way interfere with the performance of governmental functions, the Court said:

> "* * * and it certainly cannot be maintained that banks or other corporations or instrumentalities of the government are to be wholly withdrawn from the operation of state legislation. The most important agents of the Federal Government are its officers; but no one will contend that when a man becomes an officer of the government he ceases to be subject to the laws of the State. * * * The salary of a federal officer may not be taxed; he may be exempted from any personal service which interferes with the discharge of his official duties, because those exemptions are essential to enable him to perform those duties. But he is subject to all the laws of the State which affect his family or social relations or his property, and he is liable to punishment for crime, though that punishment be imprisonment or death. So of the banks. They are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the Nation. All their contracts are governed and construed by state laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on state law. It is only when the state law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional."
>
> *First National Bank vs. Commonwealth of Kentucky*, 9 Wall. 353, 76 U. S. ..., 19 L. Ed. 701, 703.

Continuing the Court said:

> "But it is argued that the banks, being instrumentalities of the Federal Government, by which some of its important operations are conducted, cannot be subject to such state legislation. It is certainly true that the Bank of the United States and its capital were held to be exempt from that state taxation on the ground here stated, and this principle laid down in the case of *M'Culloch vs. The State of Maryland*, 4 Wheat. 316, has been repeatedly affirmed by the court. But the doctrine has its foundation in the proposition that the right of taxation may be so used in such cases as to destroy the instrumentalities by which the government proposes to effect its lawful purposes in the states * * *. The principle we are discussing has its limitation, a limitation growing out of the necessity on which the principle itself is founded. That limitation is, that the agencies of the Federal Government are only exempted from state legislation, so far as that legislation may interfere with, or impair their efficiency in performing the functions by which they are designed to serve that government. Any other rule would convert a principle founded alone in the necessity of securing to the Government of the United States the means of exercising its legitimate powers, into an unauthorized and unjustifiable invasion of the rights of the States."

The same principle was announced in the case of *Bank of United States vs. Planters' Bank of Georgia*, 9 Wheat. 904, 6 L. Ed. 244, in an opinion written by Chief Justice Marshall:

> "It is, we think, a sound principle, that when a government becomes a partner in any trading company it divests itself, so far as concerns the transactions of that company, of its sovereign character, and takes that of a private citizen. Instead of communicating to the company its privileges and its prerogatives, it descends to a level with those with whom it associates itself, and takes the character which belongs to its associates and to the business which is to be transacted."

In the case of *Graves vs. New York*, 306 U. S. 465, 83 L. Ed. 927, the Court in discussing the application of immunity from taxation where the Act of Congress is silent, speaking through Mr. Justice Stone, now Chief Justice, said:

> "It is true that the silence of Congress, when it has authority to speak, may sometimes give rise to an implication as to the Congressional purpose. The nature and extent of that implication depend upon the nature of the Congressional power and the effect of its exercise. But there is little scope for the application of that doctrine to the tax immunity of governmental instrumentalities. The constitutional immunity of either government from taxation by the other, where Congress is silent, has its source in an implied restriction upon the powers of the taxing government. So far as the implication rests upon the purpose to avoid interference with the functions of the taxed government or the imposition upon it of the economic burden of the tax, it is plain that there is no basis for implying a purpose of Congress to exempt the federal government or its agencies from tax burdens which they are unable to discern. Silence of Congress implies immunity no more than does the silence of the Constitution. It follows that when exemption from state taxation is claimed on the ground that the federal government is burdened by the tax, and Congress has disclosed no intention with respect to the claimed immunity, it is in order to consider the nature and effect of the alleged burden, and if it appears that there is no ground for implying a constitutional immunity, there is equally a want of any ground for assuming any purpose on the part of Congress to create an immunity.
>
> "The theory, which once won a qualified approval, that a tax on income is legally or economically a tax on its source, is no longer tenable, *New York ex rel. Cohn vs. Graves*, 300 U. S. 308, 313, 314, 81 L. Ed. 666, 670, 671, 57 S. Ct. 466, 108 A. L. R. 721; *Hale vs. Iowa State Bd. of Assessment & Review*, 302 U. S. 95, 108, 82 L. Ed. 72, 80, 58 S. Ct. 102; *Helvering vs. Gerhardt*, 304 U. S. 405, 82 L. Ed. 1427, 58 S. Ct. 969, *supra*; cf. *Metcalf & Eddy vs. Mitchell*, 269 U. S. 514, 70 L. Ed. 384, 46 S. Ct. 172; *Fox Film Corp. vs. Doyal*, 286 U. S. 123,

76 L. Ed. 1010, 52 S. Ct. 546; *James vs. Dravo Contracting Co.*, *supra* (302 U. S. 149, 82 L. Ed. 166, 58 S. Ct. 208, 114 A. L. R. 318); *Helvering vs. Mountain Producers' Corp.*, 303 U. S. 376, 82 L. Ed. 907, 58 S. Ct. 623, and the only possible basis for implying a constitutional immunity from state income tax of the salary of an employee of the national government or of a governmental agency is that the economic burden of the tax is in some way passed on so as to impose a burden on the national government tantamount to an interference by one government with the other in the performance of its functions."

In addition to the authorities cited, we desire to call your attention to the case of *State of North Dakota vs. Olson*, 33 Federal (2d) 848, and cases therein cited.

The power of Congress to create the Federal Land Bank was sustained because of "* * * of authority to them to act for the government as depositaries of public money and purchasers of government bonds."

Again we quote from the opinion of the Court in the case of *Federal Land Bank of Saint Paul vs. Bismarck Lumber Company*, from which this appeal is taken:

> "Loaning money at interest to private enterprise is not a governmental function. The fact that a loan is made to a farmer does not distinguish it in this respect from a loan made to a butcher, a baker, or a candlestickmaker. When the land banks engage in this business, though they be governmental instrumentalities, they do not change its character. They operate in a private field for private profit in competition with private enterprise. It is true that because of congressional favor they have the advantage of an inexhaustible source from which to draw in making their loans and at a most advantageous rate of interest. But the stock of the banks is, in the main, privately owned. Indeed, it all may be owned privately. If there be dividends, the government does not participate though it own stock. Private owners of stock do participate. The banks are not banks of general deposit and discount. The business

> done by them provides no outlet for governmental securities, because, forsooth, the funds in the banks are obtained from the government itself, except in so far as their stocks and bonds are purchased and paid for by others than the government. And the theory of the Land Bank Act is that money thus derived is to be used in making the farm loans on which the bonds are based. In *Federal Land Bank vs. Priddy*, 295 U. S. 229, 55 S. Ct. 705, 79 L. Ed. 1408, the court, after analyzing the statute creating the land banks has this to say concerning them: 'They thus have many of the characteristics of private business corporations distinguishing them from the government itself and its municipal subdivisions and from corporations wholly government owned and created to effect an exclusively governmental purpose.'"

We respectfully submit that the transaction by the Federal Land Bank in purchasing lumber and other building material to repair buildings upon its farms, which farms had been acquired through mortgage foreclosure proceedings in the State of North Dakota, is not a governmental function exercised by the federal government in its sovereign capacity. It is neither necessary nor essential as such, and in that sense is not a governmental instrumentality. The sales tax imposed upon such transactions cannot be said to interfere in any way with, or impede or obstruct the United States government in the exercise and discharge of its governmental functions.

It is respectfully submitted, therefore, that the decision of the Court below should be affirmed.

ALVIN C. STRUTZ,
Attorney General.
P. O. SATHRE,
Assistant Attorney General.

October, 1941.

G. S.

SUPREME COURT OF THE UNITED STATES.

No. 76.—October Term, 1941.

The Federal Land Bank of St. Paul, Petitioner, *vs.* Bismarck Lumber Company, and John Gray, as Tax Commissioner of the State of North Dakota, Respondents. } On Writ of Certiorari to the Supreme Court of the State of North Dakota.

[November 10, 1941.]

Mr. Justice Murphy delivered the opinion of the Court.

We are asked to decide whether, in view of section 26 of the Federal Farm Loan Act of July 17, 1916 (c. 245, 39 Stat. 360, 380; 12 U. S. C. A. §§ 931-933),[1] petitioner is subject to the Sales Tax Act of North Dakota,[2] the pertinent sections of which are set forth in the margin.[3]

[1] Sec. 26. That every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation.

Nothing herein shall prevent the shares in any joint stock land bank from being included in the valuation of the personal property of the owner or holder of such shares, in assessing taxes imposed by authority of the State within which the bank is located; but such assessment and taxation shall be in manner and subject to the conditions and limitations contained in section fifty-two hundred and nineteen of the Revised Statutes with reference to the shares of national banking associations.

Nothing herein shall be construed to exempt the real property of Federal and joint stock land banks and national farm loan associations from either state, county, or municipal taxes, to the same extent, according to its value, as other real property is taxed.

[2] North Dakota Laws of 1937, c. 249.

[3] § 2. TAX IMPOSED.] There is hereby imposed, beginning the first day of May, 1937, and ending June 30th, 1939, a tax of two percent (2%) upon the gross receipts from all sales of tangible personal property, consisting of goods, wares, or merchandise, except as otherwise provided in this Act, sold at retail in the State of North Dakota to consumers or users; ..... (Laws of 1939, c. 234, Sec. 1, extends the period of the tax through June 30, 1941,

Petitioner, the Federal Land Bank of St. Paul, was created pursuant to the Federal Farm Loan Act, *supra*. In the course of its operations it acquired by foreclosure proceedings certain farm properties in Burleigh County, North Dakota.[4] To effect necessary repairs and improvements to the buildings and fences on these properties, petitioner purchased lumber and other building materials of an aggregate value of $408.26 from the Bismarck Lumber Company, a retail dealer. The Lumber Company demanded the sum of $8.02 from petitioner, representing the total amount of the state sales tax on the various purchases. This petitioner refused to pay. On March 9, 1938, petitioner filed a complaint in the District Court of Burleigh County against the Lumber Company and the State Tax Commissioner,[5] alleging the foregoing facts and praying for an adjudication of non-liability for the sales tax on the ground that petitioner is exempt under section 26 of the Federal Farm Loan Act, *supra*, and the federal Constitution. To this complaint respondents demurred. In sustaining the demurrer the trial court held that the sales to petitioner were subject to the tax, that the Lumber Company was required to collect the tax, and that petitioner was under a legal duty to pay it.

and S. B. No. 40, approved March 14, 1941, extends the tax through June 30, 1943.)

§ 3. EXEMPTIONS.] There are hereby specifically exempted from the provisions of this Act and from computation of the amount of tax imposed by it, the following:

(a) The gross receipts from sales of tangible personal property which this State is prohibited from taxing under the Constitution or laws of the United States or under the Constitution of this State.

§ 6. Retailers shall add the tax imposed under this Act, or the average equivalent thereof, to the sales price or charge and when added such taxes shall constitute a part of such price or charge, shall be a debt from consumer or user to retailer until paid, and shall be recoverable at law in the same manner as other debts.

§ 7. UNLAWFUL ACTS.] It shall be unlawful for any retailer to advertise or hold out or state to the public or to any consumer, directly or indirectly, that the tax or any part thereof imposed by this Act will be assumed or absorbed by the retailer or that it will not be considered as an element in the price to the consumer, or if added, that it or any part thereof will be refunded.

[4] Section 13 of the Federal Farm Loan Act (39 Stat. 366, 372) gives federal land banks the power "To acquire and dispose of . . . parcels of land acquired in satisfaction of debts or purchased at sales under judgments, decrees or mortgages held by it".

[5] Owen T. Owen was named as the original defendant. He resigned the office of Tax Commissioner on December 26, 1938. His successor, respondent Gray, who took office on May 18, 1939, was substituted by order of this Court on May 26, 1941.

Accordingly judgment was entered against petitioner in the amount of the tax. The Supreme Court of North Dakota affirmed the judgment of the trial court. *Federal Land Bank of St. Paul v. Bismarck Lumber Co. et al.*, 70 N. D. 607; 297 N. W. 42. The case is here because it presents a question of importance in the administration of the Federal Farm Loan Act.

We are confronted with two questions:

First—Does section 26 include within its ban a state sales tax such as this? We hold that it does.

Second—Can Congress constitutionally immunize from state taxation activities in furtherance of the lending functions of federal land banks? We hold that it can.

I. It is clear that the North Dakota statute makes the purchaser, petitioner here, liable for the sales tax. Section 6 of the Act requires the retailer to add the tax to the sales price and declares the tax to be a debt from the consumer to the retailer. Section 7 makes it unlawful for the retailer to hold out that he will absorb or refund the tax in whole or in part. The Supreme Court of North Dakota has held that the sales tax is laid upon the purchaser. *Jewel Tea Company* v. *State Tax Commissioner*, 70 N. D. 229; 293 N. W. 386. This holding was reaffirmed in the decision below. These determinations of the incidence of the tax by the state court are controlling, and respondents concede the point.

The unqualified term "taxation" used in section 26 clearly encompasses within its scope a sales tax such as the instant one, and this conclusion is confirmed by the structure of the section. In reaching an opposite conclusion the court below ignored the plain language, "That every Federal land bank—shall be exempt from Federal, State, municipal, and local taxation", and seized upon the phrase, "including the capital and reserve or surplus therein and the income derived therefrom", as delimiting the scope of the exemption. The protection of section 26 cannot thus be frittered away. We recently had occasion under other circumstances to point out that the term "including" is not one of all embracing definition, but connotes simply an illustrative application of the general principle. *Phelps Dodge Corp.* v. *Labor Board*, 313 U. S. 177, 189; see also *Helvering* v. *Morgan's, Inc.*, 293 U. S. 121, 125. If the broad exemption accorded to "every Federal land bank" were limited to the specific illustrations mentioned in the participial phrase introduced by "including", there would have been

no necessity to except from the purview of section 26 the real estate held by the land banks.

The additional exemptions granted to farm loan bonds and first mortgages executed to the land banks are proper additions to the general exemption of section 26. The bonds may be held by private persons, and, of course, the general exemption of section 26 would not extend to them. Likewise the general exemption would protect mortgages executed to the land banks and held by them, but it would not survive a transfer.

Nothing in the legislative history of section 26 commands a contrary result,[6] and a broad construction is indicated by Congress' intention to advance credit to farm borrowers at the lowest possible interest rate. The legislative history of similar exemption clauses in other statutes supports our interpretation of section 26.[7]

It cannot be seriously contended that the tax falls within the real estate exception to section 26. Obviously a tax upon the sale of building materials to be used on the real estate of a federal land bank is not a tax upon that real estate.

II. The principal argument of respondents, and the major ground of the decision below, is that Congress cannot constitutionally immunize the lending functions, or the activities incidental thereto, of federal land banks from state taxation. It runs in this

---

[6] The committee reports emphasize the tax exempt character of the farm loan bonds. S. Rpt. No. 144, 64th Cong., 1st Sess., p. 7; H. Rpt. No. 630, 64th Cong., 1st Sess., p. 8; H. R. Doc. No. 494, 64th Cong., 1st Sess., p. 11. The lengthy debates in the Senate over the constitutionality of section 26 may be explainable in part on the ground that the broad exemption thereby created would deprive the States of a large source of potential revenue. See 53 Cong. Rec. 6851-6854, 6961-6970, 7245-7247, 7305-7318, 7372-7378.

[7] Most enlightening is the recent amendment (Pub. No. 108, 77th Cong., 1st Sess.) to section 10 of the Reconstruction Finance Corporation Act (47 Stat. 5, 9) which declares that exemption includes sales taxes. The committee reports make it clear that Congress sought only to confirm its original understanding of the scope of the exemption by this amendment. H. Rpt. No. 514, 77th Cong., 1st Sess., p 2; S. Rpt. No. 292, 77th Cong., 1st Sess., p. 2. See also 87 Cong. Rec. 4255-4256, 4616, 4626-4629 (pamph.).

When Congress moved to avoid the effect of our decision in Baltimore Nat. Bank v. State Tax Commission, 297 U. S. 209, that the Reconstruction Finance Corporation was taxable on its national bank shares, the committee reports explain that section 10 "was intended to give as wide immunity as possible to the functions and activities of the corporation". H. Rpt. No. 1995, 74th Cong., 2d Sess., pp 1-2; H. Rpt. No. 2199, 74th Cong., 2d Sess.; S. Rpt. No. 1545, 74th Cong., 2d Sess.

See also the committee report on the Federal Reserve Act, in which the standard exemption clause first appeared, H. Rpt. No. 69, 63d Cong., 1st Sess., p. 39, and the report on the bill creating the Federal Savings and Loan Insurance Corporation. H. Rpt. No. 1922, 73d Cong., 2d Sess., p 4.

fashion: Congress has authority to extend immunity only to the governmental functions of the federal land banks; the only governmental functions of the land banks are those performed by acting as depositaries and fiscal agents for the federal government[8] and providing a market for government bonds;[9] all other functions of the land banks are private; petitioner here was engaged in an activity incidental to its business of lending money, an essentially private function; therefore section 26 cannot operate to strike down a sales tax upon purchases made in furtherance of petitioner's lending functions.

The argument that the lending functions of the federal land banks are proprietary rather than governmental misconceives the nature of the federal government with respect to every function which it performs. The federal government is one of delegated powers, and from that it necessarily follows that any constitutional exercise of its delegated powers is governmental. *Graves* v. *New York ex rel. O'Keefe*, 306 U. S. 466, 477. It also follows that when Congress constitutionally creates a corporation through which the federal government lawfully acts, the activites of such corporation are governmental. *Pittman* v. *Home Owners' Loan Corp.*, 308 U. S. 21, 32; *Graves* v. *New York ex rel. O'Keefe*, *supra*, 477.

The federal land banks are constitutionally created. *Smith* v. *Kansas City Title & Trust Co.*, 255 U. S. 180, and respondents do not urge otherwise. Through the land banks the federal government makes possible the extension of credit on liberal terms to farm borrowers. As part of their general lending functions the land banks are authorized to foreclose their mortgages and to purchase the real estate at the resulting sale.[10] They are "instrumentalities of the federal government engaged in the performance of an important governmental function". *Federal Land Bank* v. *Priddy*, 295 U. S. 229, 231; *Federal Land Bank* v. *Gaines*, 290 U. S. 247, 254. The national farm loan associations,[11] the local cooperative organizations of borrowers through which the land banks make loans to individuals, are also federal instrumentalities. *Knox National F. L. Asso.* v. *Phillips*, 300 U. S. 194, 202; *Federal Land Bank* v. *Gaines*, *supra*, 254.

---

[8] Sec. 6, 39 Stat. 360, 365.

[9] Sec. 5, 39 Stat. 360, 364. Sec. 13, 39 Stat. 360, 372.

[10] Sec. 13, 39 Stat. 360, 372.

[11] Sec. 7, 39 Stat. 360, 365.

Congress has the power to protect the instrumentalities which it has constitutionally created. This conclusion follows naturally from the express grant of power to Congress "to make all laws which shall be necessary and proper for carrying into execution all powers vested by the Constitution in the Government of the United States. Const. Art. I, Sec. 8, par. 18." *Pittman* v. *Home Owners' Loan Corp.*, 308 U. S. 21, 33, and cases cited. We have held on three occasions that Congress has authority to prescribe tax immunity for activities connected with, or in furtherance of, the lending functions of federal credit agencies. *Smith* v. *Kansas City Title & Trust Co.*, *supra*; *Federal Land Bank* v. *Crosland*, 261 U. S. 374; *Pittman* v. *Home Owners' Loan Corp.*, *supra*.[12] The first two of these cases dealt with the very section 26 now in issue. They are conclusive here.

In support of their argument respondents rely on *Smith* v. *Kansas City Title & Trust Co.*, *supra*, and *Federal Land Bank* v. *Priddy*, *supra*. In the *Smith* case we held that farm loan bonds, which might be secured by first mortgages accumulated in the course of the land banks' lending activities,[13] could be exempted from state taxation. In the *Priddy* case, merely as an aid to the proper construction of section 4 of the Federal Farm Loan Act giving the land banks the right to sue and be sued "as fully as natural persons", we noted that the land banks possessed some of the characteristics of private business corporations.[14] Their character as federal instrumentalities was specifically affirmed and the broad tax immunity granted to them was not questioned. Manifestly these cases do not support respondents' constitutional theories.

We cannot accede to the suggestion that the *Smith* and *Crosland* cases can be distinguished, as they were by the state court, on the ground that a sales tax upon purchases made by petitioner in furtherance of its lending functions, unlike the taxes in those cases, bears so remotely upon petitioner's functions as to be beyond the power of Congress to prohibit. We have found that the instant tax is within the scope of section 26 and that section is a valid

[12] See also Owensboro National Bank v. Owensboro, 173 U. S. 664, 667, 668; Colorado National Bank v. Bedford, 310 U. S. 41, 50, 51.

[13] Sec. 18, 39 Stat. 360, 375.

[14] See also R. F. C. v. Menihan Corp., 312 U. S. 81, 83.

enactment. It is not our function to speculate whether the immunity from one type of tax as contrasted with another is wise. That is a question solely for Congress, acting within its constitutional sphere, to determine. *Pittman* v. *Home Owners' Loan Corp.*, *supra*, 33; *Smith* v. *Kansas City Title & Trust Co.*, *supra*, 213.

Reversed.

Mr. Justice Jackson took no part in the consideration or decision of this case.

A true copy.

Test:

Clerk, Supreme Court, U. S.